Brief recordings

Pakistan Tobacco Company

Analysis of Financial Statements FY'08-3Q'09

Pakistan Tobacco Company Limited (PTC) is part of British American Tobacco, the world's most international tobacco group, with brands sold in 180 markets around the world. The company produces high quality tobacco products to meet the diverse preferences of millions of consumers, and it works in all areas of the business - 'from seed to smoke'. Pakistan Tobacco's operations in Pakistan began in 1947, making it one of Pakistan's first foreign investments. Pakistan Tobacco provides a number of reputed brands of cigarettes to consumers in Pakistan, including Benson and Hedges, Embassy, Gold Flake, Capstan and Gold Leaf.

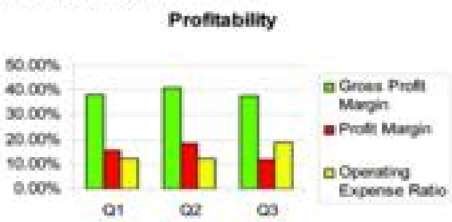
Over the years, Pakistan Tobacco has shown a rising trend as evident from the impressive growth in gross, net and operating profits, with the operating profits growing by 28% and net profit growing by 44% in 2006 compared to the previous year. The strong financial performance is attributable to significantly higher sales volume, improved margins across all brands, and continued control over cost through focus on operational efficiencies and other initiatives. The company maintained double-digit volume growth in 2006 with a record sales volume of 34.5 billion sticks - 13% higher against the same period last year (SPLY). This is a remarkable performance keeping in view the overall industry growth, which is estimated at 3%. Gold Flake remained the volume leader in the portfolio and grew at a phenomenal rate of 27% vs. SPLY, whereas Gold Leaf maintained its volume base.

	Jul-Sept 2009	Jul-Sept 2008	Variance	Jan-Sept 2009	Jan-Sept 2008	Variance
	Rs (million)		(%)	Rs (million)		(%)
Gross Turnover	11,940	[illegible]	+4.40	42,203	[illegible]	+18.80
Gross Profit	1,504	[illegible]	-5.10	4,313	[illegible]	+19.86
Operating Profit	793	[illegible]	-1.06	3,022	[illegible]	+19.86
Profit after Tax - PAT	497	[illegible]	-3.42	2,520	[illegible]	+21.34
Earning Per Share - EPS (Rs)	1.92	[illegible]	-0.52	8.85	[illegible]	+21.36

Recent performance 3Q09

The year 2009 was a turbulent period for businesses operating in Pakistan. A host of internal and external factors effected the growth and profitability of major production and retail oriented businesses. The Pakistan Tobacco Company also faced certain challenges and certain opportunities, which enabled the company to remain profitable, even in such uncertain economic environments. For the 9M09, the company saw an initial steady performance of sales and operations but the momentum could not be sustained and the 3rd quarter closed on a somewhat weaker level.

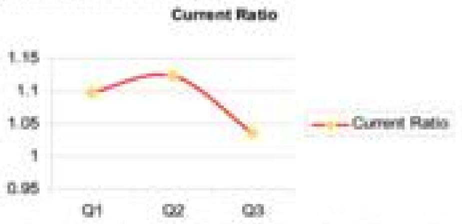
The most important factor affecting the sales and growth of profits was the considerable rise in prices mainly in the third quarter. This increment was mainly on the back of the government's imposition of additional excise duty on the products. This excise duty hit the consumer market hard, specially in the lower market segment, dominated by the Gold flake brand. Consequently, Gold Flake lost its market to the cheaper illicit segment products dominated by cheap, inferior quality, smuggled cigarettes. Furthermore, the prevalent inflation, hike in energy costs and power crisis are also adversely affecting the company's performance. During the 3rd quarter, the growth trends of profits, gross turnover and sales volumes have halted or remained flat.



The profit margin in the year 2009 started on a promising note in the first quarter. The Gross Profit margin in 1Q09 stood at 38%. This was mainly on the back of lower cost of sales and also due to lower excise duty. The gross profit during the first quarter stood at Rs 2.085 billion. During the second quarter the gross profit improved by around 28% to stand at Rs 2.673 billion. Gross profit margin for 2Q09 stood at 41%. The cost of sales during the period also stood higher by 13% but it was offset by a more than proportional rise in gross turnover. This prevented any adverse affect of rising costs on the gross profit. However, in the last month of 2Q09, the government announced an increase in the excise duty, which had adverse implications for the 3rd quarter. The 3rd quarter saw a decline in gross turnover, which declined by as much as 30% to close at Rs 11.5 billion. The main reason of decline in the gross turnover is the lost market share of the lower segment brand Gold Flake, which shifted to the illicit sector due to cheaper prices. Apart from excise duty, administrative expenses also rose during the period, eroding away the margins.

The gross profit margin for 3Q09 stood at 37.9% as against 41% in 2Q09. The profit margin on sales in the 3rd quarter of 2009 stood at 12%, down from the 2nd quarter's margin of 18%. As discussed earlier, the situational externalities are the main factor for the decline in margins. The operating expense ratio in the 3rd quarter of 2009 registered a growth and stood at 18.63%. This is also due to the rising costs of doing business in Pakistan owing to power crisis, energy and input costs, lower yields etc.

The return on asset of PTC during the 1st quarter of 2009 stood at 7.58%, which improved considerably in the 2nd quarter to around 11%. However, the 3rd quarter being hard on the firm, the return on asset declined to 3.7%. The main reason for this is the declining of net return in the third quarter and a 23% rise in total assets. The growth in assets was due to a sharp rise in stock in trade, which grew by almost 147%. The return on equity also followed a similar trend and stood at 11% in the 3rd quarter as compared to 25% in the second quarter.



The current ratio of the firm in 3Q09 stood at 1.03, a modest decline as compared to the 2nd quarter. The current liabilities for the 3rd quarter grew by around 60% for the period mainly on the back of higher trade payables and increased short term borrowing.

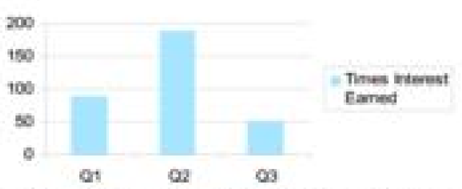
The times interest earned of PTC in the 3rd quarter were 52.5 times. This was considerably lower than the 2nd quarter's 189 times. This indicates that the debt management scenario has also been effected in wake of the situational uncertainties faced by the PTC.

Financial performance FY08

In terms of volume alone, PTC managed to sell 41.5 billion cigarette sticks, an increase of 12%. Compared to sales volume of the tobacco industry, which increased by only 2.4%, sales volume growth of PTC was remarkable. Due to this, the company increased its market share by 1.3% to a new level of 46.4%. This is thanks to two of the company's high performing brands, Gold Leaf and Gold Flake. Gold Leaf is the company's main value generator, growing at a healthy 10%. On the other hand, Gold Flake is the fastest growing brand in the market with a growth rate of 19%.

PTC managed to post a strong performance in FY08 in spite of the adverse economic situation prevalent in the country during the time. Factors such as inflation, rupee devaluation, high fuel costs, damage to company property and operations due to terrorism, and an overall recessionary trend did not dampen the sales of PTC. In fact, the Sales Turnover reached a new high of Rs 49 billion in FY08, up from Rs 41 billion in FY07. The Gross Profit was Rs 7.28 billion, an upsurge of 11.8% from the previous year's Rs 6.52 billion. The Profit for the year increased by 4.9% to Rs 2.53 billion from Rs 2.42 billion a year earlier.

Profitability of the company has witnessed a decline, but only to a nominal extent. The gross profit margin has come down to just below 15%, a change of nearly one percentage point from its last year's figure. This was seen as sales turnover of the company grew by a robust 20% but the growth in gross profit was only 12%. Many factors have led to this trend. One of them is the increased government levy on all tobacco products and producers in the form of customs duties, government sales tax and especially the Federal Excise Duty (FED). In fact, the government had announced a further increase on FED on tobacco products in February 2009. Therefore, the effect would also be seen in the company's performance of the next year. Secondly, the cost of sales rose by over 21% in FY08. Primarily, this was due to the inflationary pressures in the country, along with the high international and local oil prices. Understandably, the purchase costs of raw material and fuel and power costs contributed a hefty portion of the increased cost of sales.

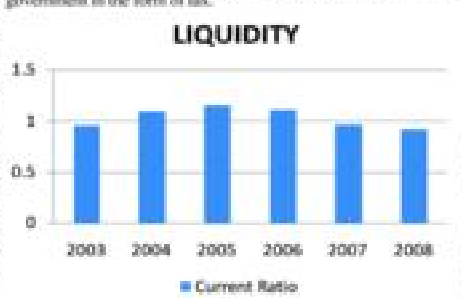


Profit margin of the company was down to 5.16% from FY07's 5.90%. Mainly, this can be attributed to a great increase in the administrative expenses, which rose by 26%. Within administrative expenses, there were prominent increases seen in the salaries and wages as well as in the fuel and power categories. These are quite obvious due to the prevalence of high inflation in the economy. Aside from these, administrative expenses included great upward movement in repair and maintenance and travelling, accounted for by the relocation and repair costs borne by the PTC since it lost its head office in the Marriott bombings. Secondly, a lower profit margin for FY08 was also due to a surge of other expenses by a whopping 89%. Again, these were the result of costs that were a result of head office relocation. Furthermore, nearly half of other expenses are made up of costs of business restructuring, which the company is going through at the moment.

The net income grew by 4.63%, which was slower than the growth seen in the total assets of the company. This is what pulled the return on assets down marginally to 24.36%, a 0.2% decrease in one year. The company's assets grew by an overall 5.79%. This was the average of the growth rates seen by fixed assets, showing a greater growth of around 8.6%, and of current assets, which grew by 2.1% only. The return on equity, however, escaped this downtrend seen in profitability ratios. ROE went up to 70.2% in FY08 compared to 65.1% last year. The reason why ROE witnessed an upsurge, in contrast to other related ratios, was that the total equity of PTC has seen a decline of 2.6%, mainly on account of decreased levels of revenue reserves which declined by 8.4% from their figure in FY07. There was no change in the share capital of PTC in the year under scrutiny.

The liquidity position of PTC worsened in the financial year 2008. Following a declining trend since 2006, the Current Ratio reached a level of 0.90 in 2008, down from 0.96 a year earlier. Basically, this happened because much more growth was seen in the firm's current liabilities compared to its current assets. In the year 2008, current liabilities grew at almost 8% while current assets' pace of growth was little over 2%. In fact, due to the slow growth, current assets now constitute 45.6% of all the assets, while previously they formed 47.23%. The main head making over 85% of current assets is that of stocks-in-trade, which only grew at 1.5%, bringing down the growth rate of current assets.

Similarly, the main growth driver of the current liabilities was trade and other payables, which grew at a rate of 21.9%. Trade and other payables form about 83% of all current assets. If we analyze further, we find that payables as FED to the government form nearly half of trade and other payables, and they grew by 30%. Something similar was witnessed in the sub heading of sales tax payable to the government. Thus, we find that a large part of the current liabilities grew because of the presence of payables to the government in the form of tax.



PTC's asset management has been very commendable in the recent past, and the same can be said about the year 2008. Inventory turnover ratio was 36.4 days in 2007, which improved to 31.2 days in FY08. Virtually, PTC's entire inventory is in the form of stock-in-trade, which has only grown by 1.5% in 2008. Comparing this with the 11% growth seen in sales turnover, the result is a faster inventory turnover. Thus, PTC was able to grow its sales by 11% by not even increasing its inventory by 2%, which is quite a feat.

One of the most striking features of PTC's asset management is its day sales outstanding ratio, which is at an astoundingly low level of 0.02 days. The ability to convert its credit sales into cash so quickly is a great achievement of the company. As a result, the company boasts an Operating Cycle of 31.21 days, down from 36.46 days in FY07.

In FY08, the total assets turnover ratio has improved to 4.72, an increase of 0.56 compared to the previous year. Growth in Sales Turnover has outpaced that of Total Assets by almost two times which led to a better TATO. As we have discussed before, Total Assets had grown at 5.8%, out of which Current Assets grew at a slower rate of 2.1%, while Fixed Assets grew by 8.64%. The major growth driver of Fixed Assets was the head of Property, Plant and Equipment, which makes up 54% of all assets of PTC, and which grew by 8.4% on account of additions to plant and machinery. Despite this, the growth shown by either Fixed or the current assets was no match for that of the sales turnover.

Deterioration was witnessed in PTC Debt Management ratios. The Debt-to-Asset ratio increased to 0.65 in FY08, up from 0.62 in FY07. A similar increase was seen in the Debt-to-Equity ratio, which was previously on the level of 1.65, but grew, to 1.88. The reason for both these trends is the high growth rate of liabilities, both current and long-term, compared to the slow growing assets, and the declining equity. The effect is even more pronounced in long-term debt-to-equity, which was 0.44 in FY08, a long way from its previous figure of 0.35. Long-term liabilities of PTC grew by 21%, mostly due to the 51% increase in the retirement benefits, which were a result of the changes made in actuarial projections.

The Times Interest Earned ratio was at 74.02 in FY08 as compared to 74.80 a year earlier. The EBIT of the company was up by 4.6% but the Finance Costs of PTC had seen a greater increase of about 6%. Thus an increase in Finance Cost of 6%, considering the high interest rates prevalent in the economy, was not able to bring about an equal rate of increase in EBIT. This deteriorated the TIE ratio to its current level.

PTC has been lukewarm when it comes to its market value. It must be mentioned that its dividend payout ratio has been high, although its dividend for FY08 of Rs 9.65 is lower than that of 2007 by Rs 0.25. The earnings per share was up by 4.65% from Rs 9.47 in 2007 to Rs 9.91 in 2008. The price-to-earnings ratio tumbled to Rs 10.73 from Rs 16.42, mainly on account of a lower market price in 2008. This was due to the ill-performing stock exchanges of the country after the economic shocks it sustained in the year, a contrast to the high-flying year of 2007. The book value per Share has decreased slightly as the equity of the company saw a small decline while the number of outstanding shares remained constant.

Future outlook

Despite the sharp decline in the third quarter performance the YTD results however still show growth and this has mainly been driven by strong performance in the first 6 months which have resulted in to date growth in gross turnover and profit numbers (PBT, PAT) vs. SPLY. The 4th quarter is expected to be tough for the business with challenges continuing to mount. Despite the adverse changes in the operating environment and slow performance of the company in the third quarter, the company's contribution to the exchequer continues to grow and is up by 20.2% versus same period last year.

The company continues to support its portfolio and build strong brands to drive growth. A premium brand, Dunhill, was the focus of the activity this quarter, with the introduction of the new panel pack in 3Q09 and continues to be a strong performer in the premium segment.

The illicit sector continues to be a threat and has started showing signs of growth with the latest Excise led price increases. This has already started to adversely affect the legitimate industry players' financials and operations. In addition to the above, severe power shortages, inflationary pressures and price hikes in leaf continue to affect the cost base of the company. Although the cost mitigation measures are in place, given the magnitude of the impacts, they may not be able to fully cover the impact of the same. Maintaining a healthy profit growth trend will be an increasingly difficult task in the current business environment with cost pressures and significant market down trading.

Economics and Finance Department, Institute of Business Administration, Karachi, prepared this analytical report for Business Recorder.

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An embarrassing day for treasury in Punjab PA

ITRAT BASHIR

LAHORE: A handful of opposition benches successfully played the quorum-busting game in the Punjab Assembly on Monday, leaving the treasury benches high and dry with a bill unattended and that too under the very nose of Punjab Chief Minister Shahbaz Sharif.

It was indeed an embarrassing day for the government and this is not for the first time that the government had to face embarrassment at the hands of absent legislators of treasury benches. Despite Speaker Rana Iqbal desperate efforts, who acted more of a party chief whip then the Speaker of the House, he could not muster enough number to keep the House in session, which was about to take up the Ali Institute of Education Bill 2008. Interestingly, the bill in question was referred back to the House for reconsideration by the Punjab Governor, which was passed by the House on November 5, 2009.

This very bill became the cause for the opposition to point out lack of quorum. Mohsin Leghari of the PML-Q on a point of order objected to its inclusion in the House's agenda on the ground that it should had been first referred to a House committee. He said it is obvious that the drafting of the bill was not satisfactory and hence it has been sent back to the House to be re-examined. "It would had been more appropriate if the bill was re-evaluated to remove anomalies (as observed by the Punjab Governor) rather than tabling it before the House. We should not show haste in drafting of bills, for which we might regret in future," he added.

The Speaker was reluctant to see his side of the argument and was determined to get the bill through in haste. Punjab Law Minister Rana Sanaullah backed the Speaker by quoting the Rules of Business, gesturing that there was no provision that prevents them from tabling the bill. Both the gentlemen missed the whole point that Mohsin Leghari tried to put across, which an American writer James F. Cooper sums up in the following words, "The wise know that foolish legislation is a rope of sand, which perishes in the twisting."

Failing to get their point of view across the House, the frustrated opposition resorted to quorum-busting game. In the first round, the treasury benches succeeded in keeping the House in session, after the Ministers literally 'hunted' for MPAs outside the House. The second round proved more fatal for the government, as the Ministers ran dry of catches and could not muster the number required. Seeing the plight of the treasury benches, the Speaker put on the shoes of chief whip and made a desperate announcement that those who are outside the House should come back immediately. This last attempt to keep the House in session also failed and the Speaker had to adjourn the House till Tuesday morning.

Interestingly, the Punjab Chief Minister Shahbaz Sharif was watching the quorum-busting game from his Chamber in the Punjab Assembly that went on for 45 minutes. While his Ministers were in a 'hunt operation', many MPAs were sitting with the CM discussing their issues. Apparently, neither the CM instructed his MPAs to go to the House nor himself visited the House, which would have encouraged others to join him. Such an attitude to the House's proceeding reflects how serious these legislators are to the well being of the province. They should ponder over the words of an American investor Peter Lynch who said, "Improved turnout will give parliament and government the appearance of being more legitimate."

The treasury benches were in hot waters throughout the session and the question-answer session on Auqaf department also proved embarrassing time for the government. Punjab Auqaf Minister Haji Ehasanuddin Qureshi's competence was exposed when he failed to answer supplementary questions put by the members of both treasury and opposition benches. He was in complete loss and only relied on written answers provided by his department. He could not satisfy the questioners on various issues, including action against Mafia of land grabbers, drug pushers supported by the department officials, appointment of favourites in the Darbar affairs committee, utilisation of income generated from Mazars, etc. To escape hard-hitting supplementary questions, he used his pet phrase 'this is a fresh question'. In fact, he had least information about his department, which made him a perfect target for the opposition, just like a sitting duck. To make the matter worse, some of the written answers (given by his department) were wrong, as was pointed out later by various legislators. His whole eligibility to head the department came under question.

Seeing the Minister's anguish, the Speaker came to his and shifted the entire responsibility towards bureaucracy. He gave the ruling that stern action would be taken against the official who had misguided the House by sending wrong answers.

Meanwhile, the opposition benches raised the issue of attack on Sheikh Rashid in Rawalpindi and Opposition Leader Ch. Zaheeruddin lambasted the government for failing to provide security to PML-Q candidate and Chief Awami Muslim League Shaikh Rasheed Ahmed'. "It seems that the PML-N wants to avoid contesting the polls," he added.

In response, Rana Sanaullah condemned the incident, but he accused the Opposition of indulging in point scoring. He assured the House that the truth would convey to the members once the investigation was completed. He observed that the attackers seem to be terrorists, who were trying to destabilise Pakistan.

Earlier, the House offered prayers for the victims of Karachi blasts. Khalid Asghar Ghural, a PML-Q legislator from Gujrat, on a point of order condemned the killing of innocent civilians in Karachi.

CHAMAN: Supply trucks wait in line after a road closure due to rain and snow in Chaman, located along the Afghanistan border on Monday.—Reuters

PML-N MNA asked to appear before court on 19th

RECORDER REPORT

LAHORE: The Lahore High Court (LHC) here on Monday directed PML-N MNA Mian Javed Latif to appear in person before the court on February 19 for interfering in functioning of judicial commission who prepared a report on a plaza situated at Sargodha Road, Sheikhupura.

The court passed these directions after, a member of commission, Noor Gujjar, told the court that as the commission visited the site on Sunday, Javed Latif along with some persons tried to create law and order situation and hence commission could not execute the measurement of the plaza. On previous hearing, court had constituted a Commission to visit the location to determine factual position and submit a report whether the plaza was built legally.

The commission is comprised of DDOR, Naib tehsildar, Patwari, president and secretary of district bar association Sheikhupura. The court issued these directions while hearing a petition of Aftab Aslam, owner of Aftab Aslam Plaza.

The court had already granted stay to the petitioner against demolition of his plaza which on Monday was extended till next date of hearing, Feb 19.

Petitioner's counsel Muhammad Azhar Siddique had alleged that the plaza was being razed in violation of court's order at the behest of PML-N MNA Javed Latif.

He argued that petitioner's ancestors were the owners of the land even before inception of Pakistan but Highways authorities had fraudulently showed him illegal occupant and started to demolish on the plea of widening the road.